

Book Reviews*

Deflation

By A. Gary Shilling, *Short Hills, NJ, Lakeview Publishing Company, 1998, pp. xxviii, 372, \$16*

The U.S. inflation rate has preoccupied policymakers and economists, not to mention the general public, for some time. However, after months of low inflation and falling commodity prices, deflation is becoming a more popular buzzword. Now, economic consultant A. Gary Shilling assembles the arguments for deflation in this book, together with his views on how deflation will affect your investments, business and personal affairs.

At the outset, Shilling differentiates between disinflation (declining but still positive rates of overall price changes) and deflation (absolute declines in prices). He also distinguishes between “good” deflation (declining prices resulting from technological advances and vast increases in supply) and “bad” deflation (a financial collapse that severely depresses incomes and final demand). He anticipates the former type to develop.

He then lists the notable deflationary forces that have been at work since early 1997: global reduction in government spending; aging populations with lower incomes and shifting spending patterns; corporate restructuring and technological innovation that promote greater productivity; deregulation; increased global supply (especially from Asia) that will lower costs; a stronger U.S. dollar that will increase competitive imports and constrain U.S. price increases; and a switch by U.S. consumers from borrowing and spending to saving. On this last point, Shilling expects a correction in an overvalued U.S. stock market that will shift consumers from confidence in stock appreciation as a substitute for saving to a retrenchment, curtailed spending patterns and greater saving.

The final part of the book is devoted to a discussion of converting those added savings into investments, plus business and personal strategies for a “good” deflationary period. For investments, quality bonds are his obvious choice. Stocks are hurt by the transition to deflation but are reasonably attractive thereafter. Commodities, real estate and other tangibles are unattractive. In business, the author offers eighteen strategies, including pushing productivity,

avoiding excess capacity and high inventories, and emphasizing financial strength. Many of the strategies seem appropriate in times of both inflation and deflation. Personal strategies include increased saving, reducing financial leverage, and sensitivity to the possibility of lower prices.

One of the attractive features of the book is a multitude of charts and tables that reinforce the points the author makes, many showing international comparisons. Unfortunately, most of the charts do not indicate the source, so that it would be difficult for a reader to check the data or duplicate or update many of the figures. However, the author is willing to supply the sources of the data to anyone who requests them.

The book is not a scholarly treatise but is written in easily understandable terms, with charts and tables that illustrate the points made. Thus, this little book is a handy guide for anyone looking for a provocative statement of why deflation rather than inflation is likely to characterize the years immediately ahead.

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Trading the Fundamentals: The Trader's Guide to Interpreting Economic Indicators and Monetary Policy. Revised Edition

By Michael P. Niemira and Gerald F. Zukowski, *New York, McGraw Hill, 1998, pp. 278, \$40.00.*

Business economists may work for a financial firm or, as corporate economists, they may have a working relationship with the Chief Financial Officer and his staff. A part of their responsibilities may involve interpreting the ongoing flood of economic data and their significance for the financial markets. Because of the rapid response of the financial markets to the latest economic data, especially unexpected information, such a job requires a solid knowledge of the key economic statistics, their rapid interpretation, and their significance for investment decisions.

A recent book that can be very helpful in this area is *Trading the Fundamentals*, written by Michael P. Niemira, Vice President and Economist for the Bank of Tokyo-Mitsubishi, and Gerald F. Zukowski, First Vice President and Senior Economist for PaineWebber, Inc., in New York. The book is in two parts. The first discusses twenty-three important monthly economic

* These book reviews have been obtained and edited by Gerald L. Musgrave, Economics America, Inc., Ann Arbor, MI, who is Book Review Editor of this journal.

indicators and their impact on the financial markets. The second part deals with the Federal Reserve, monetary policy and Treasury financing.

At the outset, the authors provide a framework for the discussion that follows. The market's reaction to an economic news report depends on the current economic backdrop, the reliability and comprehensiveness of the economic indicator, the market consensus forecast, the significance of data revisions, and the importance of the indicator to policy makers. Their approach is cyclically oriented, dividing the cycle into three phases of recession, recovery and expansion; the last is divided into rapid growth and slow growth expansion.

The twenty-three indicators are analyzed alphabetically in separate chapters. Each indicator is measured by its market significance: very high (employment and GDP); high (CPI, NAPM index, producer price index, and retail sales); moderate to high (durable goods new orders and housing starts), moderate (motor vehicle sales, consumer confidence, employment cost index, home sales, industrial production, international trade, personal income and expenditures, productivity and costs, and unemployment insurance claims); and low (business inventories, construction expenditures, consumer credit, the cyclical indicators, the federal budget, and manufacturers' new orders, sales and inventories). Every indicator is described in some detail, together with the typical release time, the reporting agency, the time period covered by the report and the web site on which it is reported. In addition, the movement of each indicator is charted, and an accompanying table provides historical perspective by providing the historic lows and highs, the normal bounds, and the series characteristics.

In the second part of the book, the authors explain that economic performance should be utilized to project possible policy actions, especially actions of the Federal Reserve. This leads to a discussion of the money supply, the Federal Reserve and the financing of the U.S. government debt. The Federal Reserve discussion is in two parts: an overview of the Fed's decisionmaking process and the framework within which it conducts monetary policy, and the mechanism by which the Fed controls the amount of reserves in the banking system. The conclusion of this part of the book covers Treasury financing patterns that affect price changes of government securities. However, interest rates and the non-Treasury fixed-income securities markets are not covered.

The book is aimed primarily at securities traders who must react quickly to economic information as it is reported on their TV screens. However, the book is a useful and an informative reference text and investment guide for business economists and investors as well. The book is well written, although some back-

ground in financial economics and the battery of available monthly statistical reports would be useful in following the discussion. For the business economist generally, it provides a helpful source of information on the key economic statistics, puts them in a useful cyclical perspective, and simplifies the explanation of the relationship between the real economy and monetary policy.

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Climate of Fear: Why We Shouldn't Worry about Global Warming

By Thomas Gale Moore, Washington, DC, Cato Institute, 1998, 175 pp. Paperback, \$9.95.

Measurement of costs and benefits is one of the economist's favorite tools. Oddly, however, when it comes to global warming, economists have focused only on one side of the ledger: the costs. Now, Thomas Gale Moore, a senior fellow at the Hoover Institution and former member of the President's Council of Economic Advisers, suggests that climate change may have benefits, as well as costs. His book explores the evidence.

It is widely (but not universally) believed that the increases in atmospheric carbon dioxide from fossil fuel burning will raise global temperatures. Moore relies primarily on the findings of the Intergovernmental Panel on Climate Change (IPCC), which estimates that temperatures may increase by between 2 and 6 degrees F by the year 2100, with its best estimate to be about 3.6 degrees F. Accepting these forecasts for the sake of discussion, Moore investigates many sources of information that shed light on the possible benefits of higher temperatures. He reviews climatic history since the last Ice Age; he probes studies that compare weather with mortality and morbidity; he studies correlations between weather and wages and weather and land prices; and he reviews other economists' broad macroeconomic studies.

In his historical section, for example, he selects population growth as one measure of human prosperity and looks at it during periods known to have been warmer or cooler than today. He finds that population growth accelerated during the warm period between 5000-1000 BC, increased very slightly during the Medieval warm period of 800 to 1200 AD, and fell during two cooling periods, the years between 500 and 600 AD and the "Mini Ice Age" between 1300 and 1800 AD. Moore also reviews human history and the changes in weather in a more anecdotal fashion. He notes that the Climatic Optimum (9000 to 4000 BC)

was the period of the invention of agriculture, the building of cities, and the transition from the Stone Age to the Bronze Age. Although the history he recounts isn't conclusive, he makes a persuasive case that in the human past warm periods have been periods in which culture and innovation flourished.

Looking at studies that show connections between health and temperature, Moore finds that in the United States the number of deaths from heat stress is small compared with the number of deaths due to weather-related cold. During the most recent ten-year period for which data are available, more than twice the number of deaths were due to cold weather compared to hot weather.

Moore also reviews studies that correlate wages and weather. Assuming that workers must be paid higher wages to overcome things they don't like about their jobs, he finds that most relevant studies suggest that workers prefer hot summers and warm winters, another sign that warming would bring benefits rather than only costs.

Then Moore scrutinizes the major economic studies done in recent years that attempt to measure the costs of climate change. One of the most extensive collections of such studies was done under the auspices of the Department of Transportation (DOT) in 1974, when the effects of climatic cooling were of serious concern. These studies found that 2 degrees F of cooling would cost the United States \$58 billion (in 1990 dollars), while warming of 0.9 degrees F would bring modest benefits estimated at \$8 billion. These DOT studies have been largely ignored in the current round of economic studies of global warming, even though they were conducted by reputable scholars and even though they measured the kind of effects economists are now looking at, such as changes in forests and changes in demand for fuel. Moore finds that the newer studies are rife with guesswork that consistently tilts

toward emphasizing the costs. For example, while William Nordhaus has done some of the "best work" on the issue, according to Moore, his conclusions tilt toward the conventional wisdom. Nordhaus states that the overall cost of global warming "is unlikely to be larger than 2 percent of total [world] output," yet his actual estimate (based on U.S. output) is only 0.26 percent of output. "How he got from one-quarter of one percent of GDP to 2 percent, he fails to explain," says Moore.

Moore also pokes holes in a massive study, *Economics of Global Warming*. That study assumes that droughts will increase, affecting farming, but it doesn't mention that most forecasts assume that rainfall will increase, and it ignores the well-documented benefits on plant growth of higher levels of carbon dioxide. In addition, it estimates that temperatures will go up more than 4.5 degrees F (the IPCC estimate at the time of his study) and assumes that sea levels will rise by three feet, when the middle-range forecast of the IPCC is half that.

Moore concludes, "...for most people, in most of the world, a warmer world would be a better world." His policy advice "...to deal with potential climate change is not to strive to prevent it...but to promote growth and prosperity so that people will have the resources to deal with any shift, whether toward a warmer or a colder climate."

This is a provocative book that economists will find worth delving into. Read it, then look on the back cover and see if you agree with the three NABE Fellows (Milton Friedman, Paul McCracken and Murray Weidenbaum) who wrote complimentary endorsements about the book.

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